Shifting Risk to Create Opportunity:
A Role for Performance Guarantees in Education

Bryan C. Hassel and Daniela Doyle

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Foreword

Despite the growing role of nontraditional providers and school operators, many school districts remain reticent, if not resolutely opposed, to turning over schools or even school functions like human resources to outside providers. Limiting the use of nontraditional providers, especially those with demonstrated effectiveness, hampers a district’s ability to supplement or substitute existing school services and bars schools from reaping the potential gains in faculty productivity, student outcomes, and cost-effectiveness. Given today’s tight budgets and shrinking staffs, this is a problematic state of affairs. It is especially so when it comes to school turnarounds, when many districts are struggling to deliver performance on their own but are also hesitant to farm matters out to an external provider—especially to those who may have limited skin in the game or those who may have thin records of success.

In “Shifting Risk to Create Opportunity: A Role for Performance Guarantees in Education,” Bryan Hassel and Daniela Doyle of Public Impact point out that uncertain results, political dangers, and unmapped responsibilities make the risk of partnering with new providers simply too great for many districts to take on. To address these challenges, Hassel and Doyle suggest a variety of performance guarantees such as warranties, bonds, and contracts that can be adapted for the case of nontraditional education providers. These tools can help spread risk and thereby facilitate partnerships as they have done in other sectors.

The power of this creative and practical solution provides a way forward for entrepreneurs who are currently locked outside the schoolhouse gate and for the districts that could make use of their skills. By mitigating uncertainty, controlling quality, sharing responsibility, and providing political cover, performance guarantees can enable the broader adoption of new providers and bolster the demand side of the school reform equation. With a sharp eye to the complexities and challenges of adapting performance guarantees to K12 schooling, Hassel and Doyle’s balanced analysis of these as-of-yet underutilized tools is both thorough and thoroughly user-friendly, going so far as to include checklists for school leaders, providers, and guarantors interested in adopting the practice. As the authors note, “Performance guarantees can only succeed in the education sector if [all] stakeholders engage as full partners in the process.”

I am confident that you will find the Hassel-Doyle piece to be as illuminating and informative as I have, especially in light of today’s tightened fiscal environment and the need for effective and efficient providers in K12 education. For further information on the paper, Bryan Hassel can be reached at bryan_hassel@publicimpact.com and Daniela Doyle can be reached at daniela.doyle@publicimpact.com. For other AEI education working papers, please visit www.aei.org/futureofeducation. For additional information on the activities of AEI’s education policy program, please visit www.aei.org/hess or contact Ms. Olivia Meeks at olivia.meeks@aei.org.

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Daniela Doyle is a consultant with Public Impact. Her work addresses a wide range of education issues, including school finance, teacher quality, school turnarounds, and early and alternative education.
Imagine that you are the superintendent of Springdale School District. Although the district’s reputation has been improving over the last five years, one of the high schools has seen its test scores, attendance rates, and graduation rates drop to new lows. Last year, just 13 percent of students were proficient in math and reading. Only 23 percent of the ninth graders who started at Springdale four years ago graduated.

You have already tried adopting new curricula, offering before and after-school tutoring, hiring a new principal, and making teachers re-apply for their positions under new contract terms. But little has changed, in part because your office does not have expertise in turning around failing schools.

Three different providers have approached you to discuss the possibility of taking over Springdale High. You have sat down with all of them and like what you hear. Each provider specializes in turnarounds and knows the research. They can point to data to support their approach. And they have honest and thoughtful answers to each of your questions.

But you face big drawbacks. Despite convincing presentations, all of the providers are relatively new and have little direct evidence to prove that they can deliver the kinds of results needed at Springdale High.

Secondly, the school board has a history of pushing back against the use of external providers. As one board member told you during a meeting to discuss Springdale High last week, “We can waste money all by ourselves.”

One afternoon, Sara D. from Transformation Schools, the newest but most persuasive provider you’ve spoken with, gives you a call.

“What can I do to convince you to give us this contract?” she asks.

“Guarantee me that 75 percent of students at Springdale will meet math and reading standards in three years, or give the district its money back.”

“No, that’s an idea,” she said. “Let me work on it.”

A week later, you get a call back. “Alright,” she says, “You got it.”

“I’ve got what?”

“You’ve got yourself a money back guarantee. Have Transformation Schools take over Springdale High, and if we can’t do what we promise, then we’ll get you your money back.”

The details take some time to work out, but in the end, Transformation Schools promises to meet the 75 percent proficiency threshold in three years. It also promises to increase attendance and graduation rates by 20 percentage points each year.

In return, Transformation Schools wants the autonomy to hire and negotiate contract terms with its staff, choose a curriculum, set the calendar schedule, and allocate the full per-pupil funding generated by the school’s students.

If Transformation Schools doesn’t meet its yearly targets, it will refund the per-pupil revenue it received from the district for every child below the benchmark. The district also has the option of cancelling the contract after the year if it is not satisfied with the results.

One of your concerns was whether Transformation Schools would actually be able to pay you back if they fell short. After all, Transformation is a young nonprofit without much of a bank balance. To allay your worries, Transformation’s largest donor, the Popkin Foundation, agreed to back a performance guarantee – and obtained a letter of credit from its bank for that purpose. Since the Foundation’s endowment is 100 times the contract price, you feel confident that Transformation Schools will honor the guarantee if necessary.

If Transformation Schools exceeds the performance goals, however, the district will pay the provider an additional $500 for every student above the target.

You confer with your school board, which is still hesitant. “We have nothing to lose,” you tell them, “except an opportunity to finally get Springdale High back on track.”
We spend more than half a trillion dollars on education each year in the United States. With that money, we hope to create informed citizens with the skills necessary to participate in government and become productive members of society. And yet, half of all low-income fourth graders are not reading at even a basic level, nearly 6.2 million students in the United States dropped out of high school in 2007, and on a recent international science exam, American 15-year-olds ranked 29th out of 43. Though the “Springdale High” described earlier is fictional, thousands of schools suffer similarly chronic low performance. Too often, hundreds of billions of dollars do not translate into high student achievement.

In response to this disconnect, the nation has seen a large increase in the number of entrepreneurial providers of education services, many of them nonprofits. Some of these ventures have demonstrated strong results, while others have produced promising early returns. KIPP, for example, has changed the likely life trajectory of many of its low-income students, 85 percent of whom now go onto college. A number of charter management organizations have entirely closed the achievement gap in reading and math, meeting or exceeding the average performance of non-low-income students in their states. And preliminary findings from an ongoing study by the RAND Corporation indicate that students in elementary and middle schools led for at least three years by principals trained by New Leaders for New Schools are academically outpacing their peers by statistically significant margins. While no one would say these organizations—and education entrepreneurs working in these and other domains—have solved the nation’s education problems, their experience suggests the possibility of significant improvements if we could harness more of this entrepreneurial energy.

The Problem of Risk Aversion

Given the magnitude of the education challenges we face, there is a strong case that districts and states should at least be experimenting with entrepreneurial provision. Like so many buyers, however, those entrusted with billions of dollars to purchase education services are risk averse. For one reason, they still face a lot of uncertainty regarding “what works.” We do not always know how to produce the student outcomes we desire, at least not consistently and not to scale. High-quality providers with a track record of success, like those described above, represent just a tiny share of the current market.

Performance guarantees have the potential to speed the rate of progress in our schools by making it less scary for education consumers to try something new, setting a bar higher for providers who want to work in the market, and disarming political opponents.

Meanwhile, any attempt to engage an outside provider in a meaningful way requires spending significant sums without any guarantee that it will actually improve student achievement. If engaging an entrepreneurial provider fails to achieve the desired results, the district or state must foot the bill and justify the effort. The threat of failure therefore keeps many from attempting bold new initiatives.

* The authors would like to thank Dan Peters and Lovett Peters for their support of this working paper. Frederick M. Hess and Olivia Meeks at the American Enterprise Institute provided helpful feedback and advice, as did the numerous education entrepreneurs and experts we interviewed in preparing this report. All errors of course remain our own.
Turning over important functions to outside organizations also places district and state leaders in an uncomfortable position, in which they must relinquish control while retaining responsibility. With limited experience overseeing contracts to deliver core educational services, leaders face a level of risk that can be paralyzing.

Political forces then compound the problem. Maintaining the status quo means preserving jobs and influence within district central offices, state departments of education, teachers’ unions, and schools, even if going a different way seems likely to generate better results. Moves to shift activity to new providers are almost always met with stiff political resistance from the organizations and individuals that stand to lose. In that context, even leaders who think entrepreneurial provision might pay off have to think twice before embarking on that path.

In light of uncertainty of results, uncomfortable role changes, and unavoidable political controversy, it is little surprise that most education agencies continue to operate as they always have: employing large staffs to carry out the work of schooling. The risks of doing anything else simply appear too great.

**Enter Performance Guarantees**

In order to improve upon, expand, and replicate the successes of entrepreneurial providers and, most importantly, raise student achievement, more districts and states must be willing to give new education services a chance. Convincing districts and states to do so, however, may sometimes require that we find a way to shift the risks associated with reform.

Performance guarantees represent such a mechanism. Although they may take any number of forms, all performance guarantees fulfill one crucial role—they make someone other than the state or district at least partially responsible for the outcome. As a result, performance guarantees have the potential to speed the rate of progress in our schools by making it less scary for education consumers to try something new, setting a bar higher for providers who want to work in the market, and disarming political opponents.

Could performance guarantees be more widely used in public education, and if so, how might they work? Below are some examples:

- A district wants to turn around its failing schools but has little faith than it can do so itself. Several nonprofit and for-profit operators are eager for the chance to try. As a condition of the contract, the district requires operators to post a “performance bond.” For every 5 points a provider falls below its improvement goals, the operator bond will pay the district back 5 percent of the fee the operator earned, up to a maximum refund of 30 percent. Operators can also earn a bonus of up to 30 percent if their schools improve faster than expected.

- A new charter middle school could guarantee a district that at least 90 percent of its students will pass the eighth grade state exams in reading and math. The school will pay the district back the half of the per pupil allotment for each student by which they fall short of that 90 percent threshold. If the school exceeds the target, by contrast, it will earn a similarly sized bonus for each student above the threshold.

- A new nonprofit teacher training program eager to “get its foot in the door” could guarantee a district that its graduates will produce, on average, 1.25 years of academic growth in reading per year. If its teachers do not meet that benchmark, the training program will pay the district $100 for every student its graduates instruct that year.

- A provider of virtual courses could sell its AP Calculus program to a state department of education, guaranteeing that at least as high a percentage of students using its program will score a 3 or higher on the AP exam as students with in-class instructors. The provider will refund the state in full if it defaults on its guarantee.

These are just examples. In any number of areas, one could imagine similar arrangements.
in which providers agreed to link some or all of their funding to the outcomes they achieved. To plumb these ideas further, this exploratory working paper reviews how performance guarantees work in other settings, explains how they could address public education’s risk issues described above, and explores a series of design issues that states and districts, as well as providers, would need to address in crafting specific performance guarantees.

How Performance Guarantees Work in Other Settings

For the purpose of this report, performance guarantees include any kind of agreement that promises a minimum level of performance and includes financial consequences for breaking the agreement. Although unusual in education, performance guarantees are quite common in other sectors, including construction, consumer goods, and even energy. The main purpose of all performance guarantees is to shift risk from the buyer to the provider. Consider the following examples:

- **A warranty for a new car.** Tom bought a brand new truck. He washes it every weekend, changes the oil every 3,000 miles, and makes sure to get it to the shop for a tune-up at 50,000 miles. At 16 months, though, the engine starts to smoke. Tom takes the truck right to the mechanic, who tells him the engine needs to be replaced—and it will cost $2,500. But the truck is still under warranty and Tom has done all of the required maintenance, so the auto manufacturer does the repair for nothing.

- **Construction with a “bonded” contractor.** Mike and Laura want to build an addition onto their house. They interview a half a dozen contractors and finally decide to hire B&B Construction, a bonded contractor. Everyone agrees to a timeline, and B&B gets to work. One week and an exterior wall into the project, though, B&B stops coming by the house and will not return Mike and Laura’s calls. The couple does not know what to do. They pull out their contract and find the number for the surety company that issued B&B its bond. The next day, B&B returns to the job site, and they complete the addition on time. If they had not done so, the bond company would have had to find another contractor or compensate Mike and Laura for the trouble.

- **Keeping secrets in reality television.** KBC’s hit reality show, America’s Next Top Principal (ANTP), just finished shooting its most explosive season yet. There has already been a ton of media buzz about the show and viewership is expected to break records—as long as no one leaks the ending. As an incentive to keep the cat in the bag, everyone involved in the production of ANTP has a clause in their contract that specifies an amount of money they must pay if they break their vow of secrecy. The amount represents an estimate of KBC’s expected losses, based on anticipated commercial revenue and varied by week, if news of the winner gets out.

- **Energy upgrades at the municipal complex.** Springfield’s state government recently mandated energy upgrades for all large government offices, including the Springfield municipal complex. Missing from the mandate, however, is the money to pay for those upgrades. Springfield contacts Eagle Energy, which recommends a package of improvements. To fund the work, Eagle Energy finances the project itself, perhaps by obtaining a loan or other funding from a third party. The city, in turn, will have to pay Eagle back for the work over 10 years. Eagle Energy guarantees, however, that the energy savings Springfield experiences over the next 10 years will meet or exceed the city’s annual payments due. If the cost savings fall short, Eagle Energy will eat the difference, so that in the end, the upgrades will cost Springfield nothing at all.
A Performance Guarantee for Every Project Type

As mentioned before, performance guarantees shift risks—including the risk of needing to replace the engine on a new car, of having your contractor go out of business after knocking down the wall between your kitchen and your backyard, of losing millions due to a loose-lipped employee, or of undertaking expensive upgrades on the faulty promise of long-term savings. Performance guarantees can differ, however, in most other respects, including the extent of the coverage, the number and types of parties involved, the conditions of the guarantee, and the process for redeeming a guarantee in case of default. Generally speaking, the specifics of a particular performance guarantee reflect the context of the situation.

The examples above illustrate four of the most common kinds of performance guarantees—warranties, surety performance bonds, liquidated damages clauses, and performance contracts—which are all described in more detail below.

Warranties
Consumers have come to expect performance guarantees in the form of manufacturer’s warranties on countless products, from big-ticket purchases like new cars, to cell phones and MP3 players, to furniture. Warranties even apply to services like overnight mail, haircuts, and timely pizza delivery. They serve as a contract between the buyer and the service provider or manufacturer, guaranteeing a certain level of buyer satisfaction or quality. If the buyer believes the product or service does not meet the conditions in the warranty, she can contact the provider and request that it fulfill the terms of the warranty. It is often up to the provider, however, to determine whether or not the warranty has in fact been violated.

Warranties differ greatly both in the amount of coverage they offer and the performance standards promised. On one extreme are providers that offer “satisfaction guarantees,” and will refund the entire purchase price—or even more—if the buyer is unhappy. Pantene hair products, for example, will refund twice the purchase price if the buyer feels that the company’s shampoo or conditioner does not produce adequate shine and frizz control. To be eligible for the warranty, the buyer must only mail the company the product receipt and her contact information.

On the other extreme are limited warranties that apply to only part of the product or service and offer repairs only. Most auto warranties, for example, will cover repair costs for problems with the engine, transmission, air conditioning system, or other high value parts for some amount of miles or for a period of time, whichever comes first. They will not cover replacements to parts that one would expect to wear out more quickly, including windshield wipers, tires, and oil. They also will not typically offer a refund or replacement if there are multiple problems and the buyer is unhappy with her purchase. To be eligible for the warranty, though, the buyer must be able to prove that the car has received all of the required maintenance.

Surety Performance Bonds
One of the most common forms of performance guarantees is a surety performance bond, especially in the construction sector. By law, only bonded contractors may work on all federal, and most state, construction projects. Bonded contractors are recommended for private jobs as well.

The bond fills a number of important roles, such as providing evidence of the contractor’s ability to complete the project on time, on budget, and to the buyer’s satisfaction. The “surety”—which is often a specialized branch of an insurance company—only issues bonds to
contractors with a strong performance track record in order to minimize its own risk. A contractor capable of securing a surety bond has therefore already undergone and passed a strict screening process that looks at past performance, capital reserves, and experience, among other criteria. Contractors generally pay the surety between 0.5 and 2 percent of the contract price to receive the performance bond, which mainly reflects the cost of underwriting the bond. If a contractor defaults on a contract and the surety must honor the bond, the surety expects to be reimbursed.

Surety performance bonds also ensure that a project will be completed. This means that in the event the contractor runs into problems, the surety issuing the bond may finance the contractor in the short term, hire a new contractor to complete the project, or give the buyer enough money to complete the project with a different vendor. Consider the earlier example of Mike and Laura’s home addition. When B&B stopped coming to work, Mike and Laura did not know the company was having financial difficulties and trying to put together enough cash to buy the materials needed to finish the job. Once the surety caught wind of the problem, it was able to finance B&B in the short term, allowing the project to continue and finish on time.

In addition to construction, surety bonds are used in a range of other areas, including car dealerships, notary publics, and public offices. In most cases, they serve as a guarantee that the individual with the bond will act properly—whether operating a used car lot in accordance with state law, honestly confirming someone’s identity, or accounting for all public dollars entrusted to a public official.

**Liquidated Damages Clauses**

A more general kind of performance guarantee is a liquidated damages clause, which can be written into any contract. This is the tool KBC would have used in the earlier example of the reality television show. The amount of the guarantee should reflect some reasonable estimate of possible damages rather than a penalty. Often, that amount is based on a formula and varies according to the timing and severity of the contract breach, which is often based on a sliding scale. If the buyer feels that the provider is in breach of contract, the provider can go to court where a judge can rule to activate the terms of the contract.

The biggest advantage of a liquidated damages clause is that it removes uncertainty from the transaction and is relatively easy to resolve in court because the damages have already been decided. It also offers the buyer protection, even when the actual damages are difficult to estimate. Since the actual damages are unknown, however, the formula for estimating the damages may prove to be exceedingly high—placing an undue burden on the provider—or exceedingly low—leaving the buyer holding the bag.

**Performance Contracts**

Performance contracts work in a very different manner from the others. A provider’s payment is tied to meeting the performance conditions. This may mean that the provider does not receive any payment at all until it meets the performance conditions, or that part of the expected fee is withheld contingent on successful completion of the work. As a result, a large amount of financial risk is shifted to the provider.

Performance contracts are a newer kind of performance guarantee that are most common in sectors like energy, where up-front costs are large and benefits are expected to accrue over the long term. A provider, like Eagle Energy mentioned above, may, for example, install an energy efficient system and earn part of the cost-savings for the life of the contract, which often spans years, if not decades.

But performance contracts could be used in other settings as well. In a sense, they are the mirror image of liquidated damages clauses. With a liquidated damages clause, the provider gets paid initially regardless of performance, but must repay the buyer if things go wrong. With a performance contract, the buyer holds the funds until satisfied with the provider’s performance.

Although there are countless other forms of performance guarantees, these four, summarized side-by-side in Table 1 (see page 8), represent a useful sample from which we can...
### What is it?

- **Warranty**: A contract between the buyer and the service provider or manufacturer guaranteeing a certain level of buyer satisfaction or quality.
- **Performance Surety Bond**: A surety (usually associated with an insurance company) agrees to cover expenses up to the “penal sum” of a project, a pre-designated amount reflecting the upper limit of liability of a particular project, in case of default.
- **Liquidated Damages Clause**: A clause in a contract that requires the provider to pay an estimate of damages resulting if the conditions of the contract are not met.
- **Performance Contract**: Contract that requires the provider to cover all up-front costs in return for a share of the cost-savings later on.

### Where is it used?

- **Warranty**: Consumer goods, services
- **Performance Surety Bond**: Construction
- **Liquidated Damages Clause**: Any contract
- **Performance Contract**: Sectors with large, long-term investments

### Why is it used?

- **Warranty**: Provides protection for consumers, especially in purchasing big-ticket items.
- **Performance Surety Bond**: Construction companies have a failure rate around 20% and sureties ensure that a contractor is capable of completing a project on time, in budget, and to the agreed specifications.
- **Liquidated Damages Clause**: Used when actual damages would be difficult or impossible to estimate.
- **Performance Contract**: Offers a way to fund projects that require substantial capital up-front to realize long-term savings.

### Who’s involved?

- **Warranty**: Buyer, Provider (the manufacturer or service provider)
- **Performance Surety Bond**: Obligee: the buyer, Principal: the contractor doing the project, Surety: guarantees the “penal sum” if the principal defaults
- **Liquidated Damages Clause**: Buyer (and their lawyers), Provider (and their lawyers)
- **Performance Contract**: Buyer, Provider

### How is the guarantee claimed?

- **Warranty**: The buyer must present evidence that the warranty was violated. The provider determines the validity of the claim and honors the warranty if the buyer is deemed eligible.
- **Performance Surety Bond**: If the surety finds the provider to be at fault, the surety may: 1. Finance the original provider to complete the project; 2. Take over responsibility for the completion of the project; 3. Pay the penal sum.
- **Liquidated Damages Clause**: The buyer takes the provider to court for breach of contract. If guilty, the provider must pay damages outlined in the contract.
- **Performance Contract**: The provider only receives payment if the conditions of the contract are met.
draw meaningful lessons for considering performance guarantees in education.

Pros and Cons of Guarantee Types for Buyers and Providers

Each type of performance guarantee just described creates a different set of pros and cons for buyers and providers. For buyers, the critical feature of these types of guarantees is the degree of certainty they afford in the event of provider underperformance. Figure 1 shows how the types array on the spectrum of certainty-for-buyers. The extreme right represents high certainty, while the extreme left represents performance guarantees with low certainty.

Performance contracts, where the provider often does not receive payment until numeric and easily quantifiable performance standards are met, is the safest kind of guarantee for the buyer. If the provider falls short, the buyer does not have to go to court, demand repayment, or otherwise take action—the buyer simply withholds payment. Surety performance bonds, for which a third party decides whether there was in fact a breach of contract, come next. Surety firms have strong incentives to treat buyers well: if they do not, they will not long be regarded as real guarantors in the marketplace. Payment is relatively certain for most warranties, but since manufacturers are often the sole judges of whether the buyer is eligible, and they clearly have a bias towards their own financial self-interest, payment is less certain.

At the other end of the spectrum, liquidated damages clauses provide no certainty of payment. If the provider goes bankrupt, for example, it is unlikely the damages will ever be paid no matter how the court rules. All of this looks different, of course, from the provider side. Specifically, more certainty for the buyer creates challenges for the provider. In the case of performance contracts, for example, the provider will not be paid until the future—and only then if it performs well. The provider must therefore find a way to finance the project up-front. That means incurring some cost of capital—but also assuming some risk that its performance (and therefore its ultimate payment) will fall short. With surety bonds, contractors do not typically have to wait until a project’s end to be paid, but the bonds carry a direct cost: the fees that must be paid to the surety. Warranties and liquidated damages contracts are much more comfortable to providers: they get paid for their products or services, and then it is up to buyers to seek redress if they are not satisfied.

Figure 1: The spectrum of certainty-for-buyers with different types of guarantees

<table>
<thead>
<tr>
<th>Liquidated Damages Clause</th>
<th>Warranty</th>
<th>Surety Performance Bond</th>
<th>Performance Contract</th>
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<tbody>
<tr>
<td>Low Certainty for Buyer</td>
<td>High Certainty for Buyer</td>
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Just because performance guarantees can significantly lower the risk for buyers does not mean that all providers are willing to offer them, however, or that the guarantees are free. It should be no surprise that the more risk the provider assumes, the more difficult it is to find a provider willing to offer that kind of guarantee. Performance contracts are nearly exclusive to the energy sector. Warranties and surety performance bonds are more common, but only because decades of data collection allow companies to estimate the risk associated
with a level of accuracy that allows them to remain profitable. Liquidated damages clauses, meanwhile, are much more difficult for buyers to enforce and are also offered by the broadest range of providers.

The Potential of Performance Guarantees in Education

Though performance guarantees are common in some other sectors, they are comparatively rare in education. Some schools and districts have offered guarantees to students and parents, promising to pay for another school’s tuition if students do not meet standards (see box on page 11, entitled “School-to-Parent Performance Guarantees”). The New Teacher Project, which recruits teachers for high-need subjects, frequently offers a money-back guarantee to districts that it will fill a certain number of positions with qualified people on time. But these arrangements are exceptions to the rule.

At the outset of this report, we discussed three barriers that prevent districts and states from harnessing greater entrepreneurial energy—uncertainty regarding “what works,” the fear of relinquishing control while maintaining responsibility, and political opposition. Performance guarantees could address each of these obstacles.

Mitigating Uncertainty. For agency leaders genuinely interested in using entrepreneurial providers, but uncertain about when to do so and which providers to select, performance guarantees could help mitigate these concerns in two ways:

- **Hedging against error to shorten the learning curve.** Some entrepreneurial endeavors will prove wildly successful, and others may never produce their anticipated results. By “hedging against error,” or lowering the risk associated with a promising new entrepreneurial effort, performance guarantees could create a space for districts and states to try methods that are based on a strong rationale, but may lack the longevity and experience to show consistent success. Policymakers could therefore spend less time debating whether or not an idea might work and more time testing it, thereby hastening the “learning curve”—the time it takes to improve. By experimenting with more good ideas on a meaningful scale, they would be able to identify which are worth pursuing and how to make good programs even better. They would also be able to abandon ideas that do not work more easily, and advance the entire reform process much more quickly than is currently possible in the risk-averse education market.

- **Discerning quality.** By increasing risk for education providers, performance guarantees could also help districts and states by creating a mechanism for identifying high quality providers. A provider’s very willingness to offer a performance guarantee reflects confidence that its services work. If districts or DOEs demand performance guarantees, though, or if enough providers offer guarantees that they become a sort of unwritten standard, performance guarantees could also rid the system of many poor providers. Only providers capable of delivering on their promise would be able to remain in business.

Sharing Responsibility. Contracting with an external provider will always require states or districts to relinquish some of their direct operational control. A good contract can mitigate the discomfort associated with this loss of control by specifying deliverables and outcomes and giving the agency clear authority to terminate the contract or not renew it. Building in a performance guarantee could
further reduce agency leaders’ concerns. By providing them with a mechanism for recouping losses, in addition to the ability to set the terms of and terminate the contract, performance guarantees shift the risk associated with an entrepreneurial endeavor so that the provider and the buyer ultimately share responsibility for the program’s success. Although the public may only hold state and district personnel accountable in the end, performance guarantees lower the stakes, and thus could increase the comfort level for state DOEs and districts to engage in more ambitious reforms.

Undermining Political Opposition. Together, these benefits could produce one more advantage: performance guarantees could help weaken political opposition to entrepreneurial provision. One argument opponents muster against entrepreneurial providers is to challenge the spending of public funds on private ventures that may or may not be effective at fulfilling public purposes. These arguments may lose considerable steam if district and state leaders can respond by saying, “If the provider fails, the public gets its money back.” With less risk to the public purse, greater incentives for providers to be effective, and, in the long term, better clarity regarding what works in entrepreneurial provision, performance guarantees could undermine political opposition to doing things differently.

Challenges and Design Options

To realize these benefits, performance guarantees must be designed effectively. The best structure will vary from one project to another, but there are at least six challenges to consider in designing any performance guarantee in the education sector: measuring results; setting performance standards; establishing criteria the buyer must meet;
determining the size of the guarantee; determining the certainty of the guarantee; and making the guarantee appealing to providers. Below is a description of each of these challenges, design options to address them, and the pros and cons of those options.

Measuring Results

The Challenge

Performance guarantees require some way to measure the provider’s performance. As a consequence, all of the familiar challenges associated with measuring results in public education come to the fore in the design of performance guarantees. First, measures simply do not exist for all of the outcomes that districts and states may want providers to guarantee. Standardized test scores and graduation rates are perhaps the two most common outcomes measured in education. For many grades and subjects, however, such tests do not exist and graduation rates do not apply. The agency or provider must then develop alternative, often less valid and reliable, metrics to assess effectiveness, or else the district or state must be willing to wait several years to get meaningful results.

Even when good metrics are available, challenges abound in attributing educational outcomes to a single program or service. Many factors that influence a student’s achievement—including the child’s teacher, the school leadership, and the student’s home life—can cloud a true program effect.

In addition, performance guarantees raise the stakes for providers. That is largely the point of using them, of course, but in the process, these high stakes can also create perverse incentives to do whatever it takes to produce the promised outcomes. As a general rule, focusing on one outcome shifts attention away from others. One common criticism of high stakes testing, for example, is that it urges teachers to “teach to the test,” or narrow instruction and spend significant time on test-taking skills. Performance guarantees could have a similar effect. The threat of losing thousands, or even millions, of dollars could push providers to take drastic measures, such as cheating, cooking the books, or pushing “problem” students out of their schools.

Design Options

Though a full discussion of performance measurement is beyond the scope of this paper, agencies can address measurement challenges in several ways:

Using multiple metrics. A performance guarantee could ask for certain achievement levels on two different tests assessing the same skills, such as a state exam and an online test. The guarantee could also rely on completely different, but related, measuring sticks, such as test scores plus student and parent satisfaction on an independent survey. Multiple metrics offer more convincing evidence of success and mitigate concerns about providers focusing too much on one outcome. The collection and analysis of multiple metrics, however, has the potential to consume valuable time and resources, an effort that the benefits may not justify.

Aligning metrics with goals. If a retailer wants to improve the quality of widgets it buys from a manufacturer, measuring the number of widgets produced, the number of hours spent on widget production, or employee retention at the widget factory will reveal little. Finding measures that go to the heart of the desired outcome is the chief quest in performance measure selection.

Using appropriate context adjustments. If districts and states want providers to take on challenging tasks (such as working with failing schools), they especially need to design performance measures that make it worth providers’ whiles to do so. Performance measures focused on improvement or growth over time, for example, may be more effective at enticing providers to gravitate toward the toughest situations.

Guarding against gaming. While multiple metrics guard against some gaming, agencies should also consider methods to discourage outright cheating. Examples include having third-party organizations administer assessments and gather other data relevant to the performance contract; using audits, unannounced visits, and other mechanisms to
detect cheating; and setting very high penalties for fraud.

Setting Performance Standards

The Challenge

Choosing measures is only the first step. It is also difficult to determine how to set appropriate targets or thresholds on which to base performance guarantees. Reform demands bold goals, but performance guarantees must also be based firmly on what is feasible. Ideally, a guarantee would push a provider to hold itself to a high standard, but if the target is too high, few providers would agree to the guarantee. On the other hand, a state or district could shortchange itself by only asking providers to guarantee a modest level of results.

Design Options

Devising benchmarks aimed towards long-term goals. By the time that students graduate from high school, they should have the skills necessary to participate as full members of society. Every state has developed standards to assess whether or not students meet those goals, as well as students’ progress towards those goals each year in school. Performance guarantees could therefore piggyback on existing standards and interim measures showing whether or not students are on track to graduation or some other outcome in the future.

Setting standards based on norms. Another option is to set benchmarks that aim only to exceed the norm by some amount. If, for example, only 32 percent of students in a district score in the proficient range on the third grade math exam each year, and a performance guarantee demanded a 100 percent improvement in proficiency rates over two years, a provider would meet its obligation if 64 percent of students reach the bar.

Setting goals for adding value. Several states have adopted value-added metrics for performance that measure how much progress students make over a given time frame. Value-added metrics provide a more personalized approach to performance standards than benchmarks or norms because the goal for each child reflects his or her starting point. At the same time, every student is expected to show growth, rather than simply showing proficiency at a particular grade level.

Establishing Criteria the Buyer Must Meet

The Challenge

Another consideration is whether or not the buyer should also have to meet certain criteria in order to collect on the guarantee. Apple will not honor a warranty on a laptop if the buyer spills a can of soda on the keyboard; a homeowner will not win a surety claim on a construction project if he has not paid the provider on time. In public education, providers may have similarly reasonable objections to paying out performance guarantees. At the Academy of the Pacific Rim Charter School and Brighter Choice Charter Schools, for example, both of which have offered performance guarantees, students and parents had to meet attendance, effort, and participation criteria to be eligible. When buying services from providers, what kinds of obligations should districts and states have to fulfill?

Design Options

Administrative responsibilities. At a minimum, districts and states would want to make performance guarantees contingent on their carrying out basic administrative responsibilities, such as paying the provider in a timely fashion.

“Raw materials.” In most cases, a provider is going to rely on the district or state to provide a number of “raw materials” needed to carry out the service. These might include access to a facility in reasonably good shape and equipped adequately with furniture and technology, access to data such as student records, and the like.

Policy support. In some instances, an agreement might obligate the district or state to maintain some policy that the provider deems important to its work. An operator taking over a failing school, for example, might insist on the authority to reassign and hire staff. If the district reneged, the provider should arguably be off the hook for the performance guarantee.

Stickier issues. Specifying buyer-side obligations becomes more difficult when providers are offering a discrete service but the
school district continues to operate the schools. Consider the example of an organization helping schools implement a particular literacy program by training and coaching teachers in the method. It seems reasonable for the provider to insist that teachers attend training sessions and that the school day include time devoted to the program. But what about faithful implementation of the model? Is that the provider’s job to ensure through good training and follow-up? Or would they have a legitimate gripe if teachers went back to their classrooms and ignored their advice?

While there are no easy answers to these questions, any performance guarantee agreement needs to consider them carefully. Evidence suggests that when a program is not implemented with fidelity, especially when core program elements are compromised, the program may not be as effective.\textsuperscript{15} Methods for guarding against such problems include identifying and sharing which core elements make the program effective, “training the trainer,” thoroughly documenting and discussing any changes to the program, providing one-on-one technical assistance, holding periodic check-up meetings to review activities and procedures and address challenges, and collecting data related to implementation.

**Determining the Size of the Guarantee**

**The Challenge**

Performance guarantees could cover any amount up to, and in some cases, beyond, the cost of the contract. When it comes to setting an amount, however, the buyer and the provider both have an interest in minimizing their risk. For the buyer, that means a larger guarantee, while for the provider, it means a smaller one. Determining the “right” size for the guarantee therefore represents another design challenge.

**Design Options**

**Establishing a maximum value.** A guarantee could cover the full contract cost or expected “damages” resulting from underperformance. But sharing risk does not necessarily require shifting it completely to someone else. People generally value the warranty on their car, for example, even though it covers just some part of the vehicle over just a portion of the vehicle’s lifetime. A guarantee set below maximum value may therefore still be effective, and perhaps even preferable.

Setting the size of the guarantee at the full value of the contract is appealing to buyers because it fully covers their financial costs. Such a large guarantee, however, could scare some promising providers out of the market who feel confident in their ability, but are not willing to put a year’s worth of work, and possibly their future solvency, on the line. On the other hand, setting the maximum value of the performance guarantee at just 10 or 15 percent of the contract price could lower the stakes of the guarantee so much that it fails to motivate the benefits described earlier.

**Applying a sliding scale.** Some guarantees offer a fixed payment in case of default. These are “all or nothing” guarantees, which consider only whether or not the provider met the contractual obligation. If, for example, FedEx does not deliver a package by their published delivery time, it will refund the delivery cost in full, regardless of whether the shipment was one minute or one week late.

In contrast, most performance guarantees use some kind of a sliding scale that adjusts the amount the provider must pay according to how close it comes to meeting the standard. If, for example, a contractor does not complete a construction project, the surety will finance the remainder of the project rather than the cost of the contract. A warranty just pays for the repair needed, rather than providing a whole new car or equivalent funding.

Most kinds of performance guarantees in education could reasonably be placed on a sliding scale. Whether a provider is trying to raise test scores, improve graduation rates, place effective teachers, or meet some other objective, it would typically be possible to determine what proportion of a performance target the provider has met, and make the guarantee work accordingly. On the other hand, all or nothing guarantees may be sometimes useful in prompting providers to go the extra mile for exceptional results, rather than settling for a lower payoff.
Determining the Certainty of the Guarantee

The Challenge

As described earlier, performance guarantees are more or less effective for buyers depending on how well the mechanism allows the buyer to redeem the guarantee if there is a default. The guarantee design must therefore consider how the claims process will work and how to ensure that the money needed to honor the guarantee is available in case of default.

Design Options

Choosing a “judge” and requiring evidence. The claims process can vary by what qualifies as evidence of a breach of contract and who ultimately decides whether a breach has occurred. On one extreme are satisfaction guarantees, under which the buyer can redeem the guarantee if at any point he is not satisfied with the provider’s work. In that case, the buyer is the judge and no evidence is needed. On the other extreme, the provider is the judge and the buyer must present a long list of detailed evidence illustrating underperformance.

Either extreme leaves the guarantee open to abuse by the party serving as judge. Another option, then, is to use a neutral third party as judge. Bringing additional players into the mix, however, will likely raise the cost of the guarantee to compensate them for their time. Truly “neutral” third parties are also difficult to find. The surety firm plays this role in the case of surety bonds, while courts serve this purpose in other cases.

Placing money in reserve. Even if the buyer controls the determination of breach (or can rely on a third party to do so appropriately), it may still face the challenge of collecting on the guarantee if it must go to the provider for a payment.

Some performance guarantees require that the provider put aside some part of the guarantee amount. The amount in reserve could represent the entire guarantee amount, or some portion. Reserves ensure that the provider can meet its obligation in case of default. The only way to assure that the money needed to pay a guarantee will be available is for a third party to hold the guarantee amount. Hotels take your credit card number for incidentals and rental companies require first and last month’s rent for this purpose.

But money put aside for months or years in case a provider defaults on its guarantee, or to purchase a particular type of guarantee, is money not spent to develop and deploy new or additional education services. Reserve requirements can therefore tie up investment dollars for other endeavors. Rather than speeding the pace of reform, there is the possibility that performance guarantees could actually slow it down by taking money out of educational entrepreneurship. Of course, the larger the reserve requirement, the greater the impediment to cash flow.

Using “bonds” or similar instruments. As described above, one way actors in other sectors deal with the certainty issue is by having providers purchase “bonds” from third parties, which are then responsible for paying buyers in the event of non-performance. Rather than requiring the provider to set aside large amounts of money, creating the cash flow problem described previously, a bond requires the provider to pay a relatively small fee. The bond company collects fees from many providers, but only has to pay out in limited cases.

Education entrepreneurs—especially new ones—are unlikely to be able to handle performance guarantees that require large set-asides of funds. As a result, some form of a bond or similar financial instrument is much more promising. How those might work in the K-12 context is the subject of a later section.
Making the Guarantee Sufficiently Appealing to Providers

The Challenge

A final overarching challenge is that in designing performance guarantees that “work” for themselves, districts and states could easily make them so buyer-friendly and stringent that few providers would agree to them. As a result, districts and states need to strike a delicate balance between designing guarantees that are rigorous enough to provide value to the public, but that are also sufficiently attractive to the providers.

Design Options

While many of the above design options address this point, two other direct options are worth mentioning here:

Offering “upside” potential. Performance guarantees can seem like all “stick,” but there is no reason why districts and states cannot pair these with more “carrot.” An agency could offer to pay a bonus to any provider that exceeds the performance targets that trigger the guarantee. As a result, providers would face the risk of falling short, but also the upside of achieving exceptional results.¹⁶

Using markets and “auctions” to set target performance levels, guarantee sizes, and other parameters. When districts and states struggle to strike the balance between the aggressiveness of guarantees and their attractiveness to providers, one possible path to resolution is to allow a market or auction mechanism to set the parameters. Suppose, for example, that a district wants to hire outside organizations to turn around its failing schools. The district does not know what level of improvement it should expect in a two-to-three year period. It does not want to set the expectation too low (it has been doing that for years!), but it realizes no providers will sign up if the targets are too high. In this instance, the district could ask providers to state, as part of their proposals, the performance targets they would propose for their efforts and the amount of their fee they would be willing to put at risk if they fall short. The district could make clear that it would judge proposals, in part, on the aggressiveness of these guarantee parameters. Such a process would give providers an incentive to bid high, but within the bounds of what they believe is possible.

Such an approach would only work if the supply side of the market is somewhat robust: if just one or two providers are interested, there will be little competition on this issue and guarantees will likely be minimal or non-existent. Even in a thick market, because of the newness of the guarantee concept, the auction mechanism is unlikely to work smoothly in the short term. As time goes by and experience accumulates, however, the market for guarantees would likely become fine-tuned. In the meantime, the district or state would capture the benefits of performance guarantees while avoiding performance thresholds and other terms that make providers run for the hills.

Making the Financing of Guarantees Viable in K-12

Even if districts and states geared up to use performance guarantees and tackled all the design challenges above, providers would face their own challenges working under a performance guarantee regime. The most significant of these is how to finance the guarantees into which they would be asked to enter. Many of the most promising education entrepreneurs are nonprofit organizations with limited capital to use as collateral for or to pay performance guarantees. Even if they are capable of meeting high performance standards, they may not be able to meet the requirements to enter into a guarantee arrangement – most notably a bank account large enough to both honor the guarantee and conduct their work. For these reasons, the sector would need creative financing structures in order to make performance guarantees work.

In other sectors that use performance guarantees, two primary financing mechanisms to deal with this challenge have come to the fore, both of which are described above. With a surety bond, a third party agrees to pay the buyer in the event of a default. The provider pays only a small fee, leaving all of its cash available for carrying out the project. With a performance contract, a provider without its own resources obtains financing (e.g., a loan)
from a third party to carry out the project, and then is repaid in the future by the buyer if performance is satisfactory.

In either case, a third party provides the key, earning a fee and/or interest for playing the role of financier. In addition to providing the money itself, these third parties also play a quality control role. They will not provide this financing to just anyone – providers have to meet standards, and keep meeting them, to gain the support of the financiers.

Who could play these third-party roles in public education?

**Philanthropies.** Philanthropies represent a natural partner since they already play a large role in education entrepreneurship. They make strong partners because they know the education sector, and are therefore best positioned to identify strong investments – as well as weak ones. Philanthropies could play either of the two roles described above. They could offer “bonds” to nonprofits they support, or promise to pay the nonprofits’ district and state customers if they fail to perform. They could enact these promises by, for example, arranging with their banks to secure letters of credit (LOC), documents that authorize the project owner to draw on the money in an account set aside for the project if the terms of the guarantee are not met. Or, they could offer loans or other financing directly to nonprofits to support their operations while they are waiting to be paid at the end of a job.

One appealing aspect of both roles is that foundations could carry them out without, in the short term, using up scarce grant-making resources. Instead, they could use their endowments, the underlying “corpus” of funds that most foundations have. Whether a future promise to pay or a current loan, the assistance would take the form of a program related investment, or PRI. Unlike a grant, the philanthropy could expect to get back its investment money at the project’s end. As this system is taken to scale, however, there is a greater chance that a significant amount of philanthropic dollars could be tied up backing investments. But time and experience will also allow philanthropies to more accurately evaluate providers, calculate the risk associated with each investment, and determine how much of their endowment – funding not currently “in play” – they feel comfortable using to back performance guarantees.

Of course, dedicating a portion of an endowment in this way would have costs. Banks would charge foundations for LOCs underlying future promises. Loans to nonprofits could earn interest, but perhaps at rates below what the endowment would otherwise earn on its investments. And the funds would be at risk: if the nonprofit fell short, the foundation would be on the hook to pay (in the case of a bond) or would likely see the nonprofit default on its loan.

Foundations would likely incur these costs and take these risks only if (a) they had great confidence in the nonprofit’s ability to perform, and (b) they believed that backing performance guarantees would unlock significant new “business” for the nonprofit, enabling it to scale up its impact. If both conditions held, guarantee-backing would be an appealing way to help a nonprofit grow without much outlay of funding. Without both conditions, foundations would likely prefer more traditional ways of supporting their beneficiaries.

**For-profits.** Banks and sureties have already shown that they are willing to assume the risk associated with performance guarantees if they have the opportunity to turn a profit. If performance guarantees in K-12 education allowed for-profit groups to make money, these traditional agents might be willing to provide these same services for education entrepreneurs.

It would be wrong to assume, however, that they would flock to this market. The story of charter school facilities financing offers a helpful tale in this regard. Like performance guarantees, facilities financing is of course commonplace in other sectors, with a well-developed industry of various financial players. Yet, this industry did not immediately move to meet the need charter schools faced for facilities funding. Though charter financing resembled other kinds of commercial lending, there were enough differences to give banks pause. They lacked loan officers with industry-specific knowledge needed to determine whether schools were a good financial bet. And they
were understandably anxious about the political risk attached to charter schools – both the risk that an individual charter school could have its charter revoked, and the more general risk that the state legislature could curtail charter schools or their funding.

Charter school facilities financing remains a significant challenge, but prospects have improved in ways that are relevant to performance guarantee support. First, traditional lenders have simply become more comfortable with charter school financing with experience.

Second, numerous hybrid approaches – combining philanthropic and for-profit capital – have developed, lowering the risk-bar enough that more conventional lenders are willing to play a role. In a recent example, the Bill and Melinda Gates Foundation announced that it was providing $30 million in “credit enhancement” that would make possible $300 million in for-profit conventional financing for charter management organizations, such as KIPP Houston. In addition, specialized enterprises have grown up to address the challenge, such as organizations that build, renovate, and lease facilities for charter schools and even special-purpose charter school lenders.

Such hybrid arrangements, perhaps, would be likely to emerge in a world of performance guarantees in public education, with philanthropic and commercial players teaming up to meet the risk challenge. Spreading risk among a greater number of organizations reduces the burden for any single organization and allows different players each to find their own appropriate level of risk-taking.

Conclusion & Next Steps for Implementation

Performance guarantees can only succeed in the education sector if three kinds of stakeholders engage as full partners in the process – state and district education agencies, providers, and guarantors. Just as a triangle ceases to exist without all three points, performance guarantees are not possible without these three actors because each has what the other needs (See Fig. 2 on Page 17). Since using performance guarantees is a radical idea in the education sector, its implementation represents a break from the status quo that is only possible if key players take specific actions to create a receptive environment. Below, we outline next steps stakeholders could take to put performance guarantees into practice.

State and District Education Agencies:

1. Accept that there is a role for external providers. To meet the substantial challenges faced by public education, state and district agencies will typically need help from specialized organizations that are sometimes better positioned to do certain kinds of critical work.

2. Be willing to relinquish some types of control. Using external providers effectively requires that district and state leaders allow providers the autonomy to operate. It is not efficient, and may even be counter-productive, to micromanage the work of external providers.

3. Recognize that you still have accountability. Relinquishing control can be a frightening prospect, but performance contracts allow district and state leaders to maintain crucial levers of accountability by terminating contracts and claiming guarantees in the event of non-performance.

4. Identify your feasibility zone. Identify an area where your schools could most benefit from outside expertise and then develop goals and criteria for each of the challenges outlined in this report. What do you need a provider to offer as part of a performance guarantee?

5. Make your intentions known. Make public the fact that you are looking for providers to accomplish a particular task while also guaranteeing their results.
Figure 2. The relationship between stakeholders in a performance guarantee

**State / District:** The state or district wants the expertise and results that a high-quality provider can offer, but it is only willing to outsource if it can maintain accountability through a reliable performance guarantee.

**Provider:** The provider wants access to a new or larger market, but can only access it if the guarantor can back its performance guarantee.

**Guarantor:** The guarantor wants to lend its support to one or more providers via a guarantee, but needs a state or district willing to engage the guaranteed provider.

**Providers:**
1. **Identify the results you could guarantee.** What results do you feel confident that your organization can consistently produce?
2. **Identify your feasibility zone.** How much capital are you willing to use to back that guarantee, either as collateral or through a premium or fee? Who could partner with you to back the guarantee?
3. **Make it a two-way street.** What conditions would the state or district have to ensure for you to guarantee a certain level of performance (e.g., certain funding levels or autonomy)? Spell these out clearly in any performance agreement.
4. **Make your intentions known.** Publicize the fact that you are willing to guarantee your services. Advertise your services and guarantees to states and districts and seek the support of partners to back the guarantee.

**Guarantors:**
1. **Identify your feasibility zone.** How large a guarantee would your organization be willing to back? What would you need the provider to offer in return? How would serving as a guarantor in this manner affect other investments?
2. **Research potential partners.** Identify promising providers that you may be willing to back in a performance guarantee. Philanthropies could start with present grantees.
3. **Design for sustainability.** Performance guarantees are most likely to thrive and spread as a mechanism if they “pay for themselves” in some way. For example, construction contractors pay surety bond firms a fee or premium, which covers the surety’s costs and profits.
4. **Make your intentions known.** Advertise the fact that you are willing to provide financial
backing for promising providers willing to guarantee their results.

5. Collect data. The ability for a philanthropy or private sector firm to underwrite performance guarantees in the education sector broadly will require that they reliably assess the risk associated with each investment. Data collection is central to that, and so guarantors can support the success and sustainability of performance guarantees by collecting and compiling all data related to the practice.

Performance guarantees represent one mechanism for improving upon, expanding, and replicating the successes of providers to raise student achievement. While the appeal for the education sector of a tool often reserved for construction, automobiles, and reality television may not be obvious, performance guarantees could meet a crucial need: enabling more states and districts to tap the power of outside help without assuming all the risk.
Based on 2007 NAEP results for free and reduced price lunch students. Available from the National Center for Education Statistics at: http://nces.ed.gov/.


3 Based on 2006 PISA exam. See the PISA website for details, available at: http://www.pisa.oecd.org/.


5 Based on data supplied by KIPP, NewSchools Venture Fund, and New Leaders for New Schools.

6 For example, see: Terry M. Moe and John E. Chubb, Liberating Learning, (San Francisco, CA: John Wiley & Sons Inc., 2009).


9 Information on performance surety bonds comes largely from the Surety Information Office (SIO), available at: http://www.sio.org/. We also interviewed Robert J. Duke, Director of Underwriting/Assistant Counsel at The Surety & Fidelity Association of America, on November 2, 2009.


16 While bonuses would obviously be attractive to providers, they would create a potential financing challenge for states and districts. If some providers fall short of targets and others exceed them in rough balance, the district or state could fund bonuses out of funds recouped from low performers, a very appealing form of redistribution. But if winners outnumbered losers, the district or state would have to come up with additional funding. One way to address this would be to have higher levels of government, or outside philanthropies, create an “exceptional performance fund” to cover such shortfalls. Funders might be willing to do so because they would only have to pay out in the happy event of stronger than expected results.


18 A provider could serve as its own guarantor if it had sufficient assets. Many potential education providers, however, are nonprofits or start-up enterprises without the ability to offer a credible guarantee alone.